

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 AID-05 CEA-01 CIAE-00 COME-00
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OMB-01 EURE-00 XMB-02 STR-04 /090 W
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P R 191751Z APR 77
FM USMISSION OECD PARIS
TO SECSTATE WASH DC PRIORITY 6201
INFO AMEMBASSY BERN
AMEMBASSY BONN
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AMEMBASSY THE HAGUE
AMEMBASSY LONDON
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C O N F I D E N T I A L SECTION 01 OF 03 OECD PARIS 11461

PASS TREASURY FOR ASSISTANT SECRETARY BERGSTEN AND
FRB FOR GOVERNOR WALLICH

E.O. 11652: GDS
TAGS: EFIN, ECON, OECD
SUBJECT: EPC'S WORKING PARTY 3 MEETING ON APRIL 16:
POSITIVE JUDGMENT ON IMF STANDBY WITH ITALY

REF: OECD PARIS 10657

1. SUMMARY. WP-3 MET BRIEFLY ON APRIL 16 PRIOR TO
MEETING OF GROUP OF 10 DEPUTIES ON SAME DAY. PURPOSE
OF SUBSTANTIVE DISCUSSION WAS TO CONSIDER STANDBY
NEGOTIATED BETWEEN IMF AND ITALY AND TO OFFER JUDGMENT
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THEREON AND ON ITALIAN BALANCE OF PAYMENTS PROSPECTS
TO G-10 DEPUTIES, IN LINE WITH TRADITIONAL WP-3
FUNCTION IN CASES WHEN G-10 WAS ASKED TO CONSIDER
MOBILIZATION OF GENERAL ARRANGEMENTS TO BORROW (GAB).
WHILE SEVERAL QUESTIONS WERE RAISED ABOUT DETAILS
OF ITALIAN PROGRAM, AND OF GOI'S INTENTIONS TO ADHERE
TO IT, WP-3 (THROUGH CHAIRMAN'S SUMMATION) ENDORSED

PROGRAM EMBODIED IN IMF STANDBY AS COHESIVE, COURAGEOUS GIVEN ALL THE CIRCUMSTANCES, AND DESERVING OF SUPPORT, IN OVERALL JUDGMENT WHICH RECOGNIZED THAT STANDBY WAS ONLY FIRST STEP IN MEDIUM TERM STRUCTURAL TRANSFORMATION WHICH WAS REQUIRED FOR ITALIAN ECONOMY. WP-3 TENTATIVELY AGREED TO HOLD NEXT MEETING ON MAY 26, POSSIBLY RUNNING OVER INTO MORNING OF MAY 27. END SUMMARY.

2. WP-3 CHAIRMAN (EMMINGER), RECALLING WP-3'S TRADITIONAL FUNCTION OF CONVEYING A JUDGMENT TO G-10 ON COUNTRY SITUATIONS WHEN G-10 DUE TO CONSIDER MOBILIZATION OF GAB, INVITED DISCUSSION OF STANDBY NEGOTIATED BETWEEN IMF AND ITALY.

3. IMF REPRESENTATIVE (WHITTOME) SUMMARIZED MAIN FEATURES OF ITALIAN PROGRAM, WHOSE PRINCIPAL OBJECTIVES WERE PRICE STABILIZATION AND IMPROVEMENT IN BALANCE OF PAYMENTS POSITION. IN DESCRIBING PROGRAM, WHITTOME PARTICULARLY STRESSED THE FOLLOWING:

A) FISCAL PROGRAM REPRESENTS SERIOUS EFFORT BOTH ON REVENUE COLLECTION SIDE AND ON SIDE OF BRINGING VARIOUS EXTRA BUDGETARY PUBLIC EXPENDITURES, ESPECIALLY LOCAL AUTHORITIES AND HEALTH INSTITUTES, UNDER SOME CONTROL. A GREAT DEAL OF SUSTAINED IMPLEMENTATION OF THE FISCAL OBJECTIVES WOULD BE REQUIRED;

B) WHILE ON PRICE AND WAGE FRONT MANY DIFFICULTIES
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REMAIN, MAXIMUM HAD PROBABLY BEEN DONE UNDER PREVAILING CIRCUMSTANCES. IT WAS HOPED THAT DURING THE SUMMER AND AUTUMN FURTHER SMALL STEPS COULD PROGRESSIVELY BE TAKEN AND THERE WAS EVERY REASON TO HOPE FOR A DECELERATION OF PRICES. IN ANY EVENT, ITALIAN STANDBY INCLUDED SIGNIFICANT INNOVATION IN IMF PROGRAMS BY INTRODUCING FOR THE FIRST TIME A SPECIFIC TARGET FOR DAMPENING THE RATE OF PRICE INCREASE, WITH THE UNDERSTANDING THAT, IF THESE TARGETS ARE EXCEEDED, GOI WILL BE FORCED TO RECONSIDER THEIR POLICIES TOWARD WAGE INDEXATION; AND

C) INTERVENTION IN EXCHANGE MARKET WILL BE LIMITED TO OPERATIONS DESIGNED TO MINIMIZE DISRUPTIVE SHORT-TERM FLUCTUATIONS.

4. QUESTIONS DIRECTED TO THE ITALIANS CONCERNED PRINCIPALLY DEGREE OF SOCIAL AND POLITICAL CONSENSUS ON STANDBY (JAPAN), COMPATIBILITY OF DOMESTIC GROWTH

ESTIMATES, BALANCE OF PAYMENTS OBJECTIVES, AND EXCHANGE
RATE POLICY (FRANCE), WHAT ITALIANS WOULD DO IF

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P R 191751Z APR 77

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TO SECSTATE WASH DC PRIORITY 6202

INFO AMEMBASSY BERN

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C O N F I D E N T I A L SECTION 02 OF 03 OECD PARIS 11461

PRICE TARGETS OF STANDBY EXCEEDED (EMMINGER), RELATION-
SHIP OF STANDBY TO DESIRABLE MEDIUM TERM STRUCTURAL
CHANGE (SWISS), AND EXTENT OF FOREIGN INDEBTEDNESS
OF ITALIAN BANKING SYSTEM (WALLICH).

5. ITALIAN REPRESENTATIVES (PALUMBO AND MAGNIFICO)
INDICATED THAT ELEMENTS OF STANDBY HAD BEEN THOROUGHLY
DISCUSSED IN ITALY AND THAT IN PARTICULAR FEATURES
RELATING TO WAGES AND SCALA MOBILE HAD BEEN NEGOTIATED
BETWEEN GOVERNMENT AND UNIONS. ALL PARTIES, INCLUDING
UNIONS AND INDUSTRY, HAVE AGREED THAT PLANT LEVEL
COLLECTIVE BARGAINING WILL NOT BE USED TO INCREASE
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WAGES. IN THE EVENT THAT PRICE TARGETS INCLUDED IN
STANDBY ARRANGEMENT WERE TO BE EXCEEDED, ITALY IS
COMMITTED TO TAKE "ANY APPROPRIATE MEASURES". SUCH
MEASURES WOULD CLEARLY BE IN THE FISCAL FIELD.
GOI IS MORALLY COMMITTED TO THE UNIONS NOT TO USE
INDIRECT TAXATION INCREASES AS A WEAPON DURING 1977,
AND THIS POINTS TO THE LIKELIHOOD THAT DIRECT TAXATION
WOULD BE USED, PERHAPS COMBINED WITH FURTHER INCREASES
IN RATES OF THOSE ADMINISTERED TARIFFS WHICH DO NOT
ENTER INTO THE CALCULATION OF THE PRICE INDEX USED
FOR THE SCALA MOBILE.

6. ITALIAN DELEGATION FELT THAT GIVEN THE DEPRECIATION
OF THE EXCHANGE RATE DURING 1976, AND ITS FURTHER
DEPRECIATION BY ABOUT 4 PER CENT SO FAR IN 1977,
ITALIAN AUTHORITIES SAW NO NEED FOR ANY SUBSTANTIAL
CHANGE IN THE EFFECTIVE RATE OF THE LIRA DURING THE
YEAR IN ORDER TO ACHIEVE BALANCE OF PAYMENTS OBJECTIVES.
THESE IMPLIED THAT CURRENT ACCOUNT WOULD GRADUALLY
MOVE FROM DEFICIT INTO SURPLUS DURING THE COURSE OF
THE YEAR, WITH A TURN-AROUND FROM A DEFICIT OF ABOUT
\$500 MILLION IN THE FIRST QUARTER OF 1977 TO A SURPLUS
OF \$500 MILLION IN THE FIRST QUARTER OF 1978. SWING
IN BALANCE OF PAYMENTS WOULD TAKE PLACE AT A TIME WHEN
GROWTH RATE IN DOMESTIC GNP WOULD BE DECELERATING.
DURING COURSE OF 1977 GNP MIGHT GROW BY 2 PER CENT
AND IMPORTS BY ABOUT 3-1/2 PERCENT, GIVEN AN ESTIMATE
OF INCOME ELASTICITY OF IMPORTS OF 1.8. EXPORTS,
ON THE OTHER HAND, SHOULD INCREASE BY ABOUT 9 PER CENT,
IMPLICATION BEING THAT RESOURCES WOULD BE SHIFTED FROM
DOMESTIC CONSUMPTION INTO EXPORTS.

7. WITH RESPECT TO FOREIGN DEBT POSITION OF ITALIAN
BANKS, ITALIAN REPS INDICATED THAT NET FOREIGN
LIABILITIES OF ITALIAN BANKS AMOUNTED TO ABOUT \$3.7
BILLION AT THE END OF FEBRUARY, 1977, OF WHICH PERHAPS
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\$1 BILLION WAS ASSOCIATED WITH FOREIGN FINANCING OF
ITALIAN EXPORTS. DEBIT POSITION HAD INCREASED BY
ROUGHLY \$2 BILLION DURING 1976 AND BY ANOTHER \$1 BILLION
DURING THE FIRST TWO MONTHS OF 1977. ITALIANS FELT
THAT IT WAS LIKELY THAT BANK BORROWING WOULD TEND TO
INCREASE RATHER THAN DECREASE BECAUSE ADMINISTRATIVE
REQUIREMENTS REGARDING FOREIGN FINANCING FOR TRADE

WOULD BE CONTINUED AND TIGHTNESS OF DOMESTIC CREDIT
WOULD BE AN INCENTIVE FOR FOREIGN BORROWING.

8. IN REPLY TO SWISS POINT WHICH SOUGHT TO PROBE
THE RELATIONSHIP BETWEEN DESIRABLE MEDIUM TERM
STRUCTURAL CHANGES IN ITALIAN ECONOMY (AS EMPHASIZED
IN OECD'S ANNUAL SURVEY OF ITALY) AND MORE SHORT-
TERM EMPHASIS IN IMF LETTER OF INTENT, ITALIANS

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ACKNOWLEDGED THAT IMF STANDBY PROGRAM REPRESENTS
DIFFICULT BALANCING ACT BETWEEN LONGER TERM OBJECTIVES
AND PRESENT ECONOMIC AND POLITICAL REALITIES. NEVER-
THELESS, LETTER OF INTENT SHOULD BE SEEN AS PART OF A
PROCESS OF STRUCTURAL TRANSFORMATION WHICH GOI
INTENDS TO PURSUE, AND PURSUE WITHOUT RESORT TO
RESTRICTIVE MEASURES WHICH PROHIBITED BY PARAGRAPH 18
OF LETTER TO IMF.

9. CHAIRMAN EMMINGER SUMMARIZED WP-3'S CONCLUSIONS AS
RECOGNIZING THAT MOVING POLICIES TOWARD DESIRABLE
MEDIUM TERM OBJECTIVES WOULD BE NECESSARY AND THAT THIS
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WAS PARTLY RECOGNIZED BY FACT THAT STANDBY HAD A
RELATIVELY LONG DURATION, I.E., UNTIL END 1978. PROGRAM
EMBODIED IN THE STANDBY IS THE BEGINNING OF THE PROCESS
AND CONSISTS OF A COHESIVE PROGRAM WHICH TAKES ACCOUNT
OF ALL RELEVANT ELEMENTS. WORKING GROUP ASSOCIATES
ITSELF WITH THE FUND'S JUDGMENT, NOTES THAT THE PROGRAM
REPRESENTS A POLITICALLY COURAGEOUS ACT, AND THAT IT
DESERVES SUPPORT BY THE INTERNATIONAL COMMUNITY,
INCLUDING MOBILIZATION OF GAB RESOURCES.

10. CHAIRMAN SUGGESTED THAT SUBJECT TO FURTHER
CONSULTATIONS, NEXT MEETING OF WP-3 BE SCHEDULED FOR
THURSDAY, MAY 26, WITH POSSIBILITY OF CONTINUING ON
MORNING OF FRIDAY, MAY 27. HE NOTED THAT THESE DATES
MIGHT BE CONVENIENT FOR CERTAIN MEMBERS WHO WOULD BE
EXPECTED TO BE IN PARIS AROUND THAT TIME FOR OTHER
MEETINGS (CIEC SENIOR OFFICIALS AND MINISTERIAL).
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Message Attributes

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